



STATE OF ARIZONA

JANICE K. BREWER
GOVERNOR

EXECUTIVE OFFICE

December 4, 2009

The Honorable Trent Franks
United States Representative
2435 Rayburn House Office Building
Washington, DC 20515-0302

Dear Representative Franks:

I am writing you today to seek your assistance on a matter of the highest urgency for the State of Arizona: relief from existing – and the prevention of future – unfunded federal mandates and maintenance of effort requirements, including requirements in any health care reform legislation that may be enacted by Congress. I am not requesting this assistance lightly, and I am not asking for this assistance to rescue the State from its fiscal problems; I am asking for this assistance to prevent additional financial calamity. For you to understand my reasoning for such a request, I need to explain our State's precarious fiscal situation.

The Economy

As you are all aware, these are trying economic times. Both Arizona and the nation are suffering through the worst economic recession since the Great Depression. Since the recession officially started in December 2007, Arizona's unemployment rate has increased from 4.3 percent to 9.3 percent, reflecting the loss of some 271,100 jobs. My economic advisors tell me it may get worse. Our job growth has fallen from the 2nd highest in the nation to 49th.

Since the start of the recession, arrivals at Sky Harbor Airport are down 12.3 percent, retail sales activity is down 19.7 percent, home prices have fallen 41.8 percent, contracting activity is down 51.8 percent, and the Arizona consumer confidence index has fallen approximately 55 percent.

The State's Fiscal Situation

The precipitous state of our economy has had a profound impact on State government finances. We have experienced three successive years of revenue decline and for the current fiscal year we are anticipating that our revenues will be only two thirds the revenues we collected in fiscal year 2007. This decline has been accompanied by continuing enrollment growth in our K-12, community college and university systems, extraordinary growth in our Medicaid population, and continued obligations for public safety and general governmental services.

The State of Arizona has been affected by this problem for three years as the recession first appeared and then got progressively worse. The initial attempts at balancing the budget were tentative – using "rainy day" funds, reducing agency budgets, sweeping funds and selling assets.

We also accepted ARRA funding, which temporarily mitigated the impacts to our education and health care system.

Since I took office, we have enacted the largest reductions to state spending in Arizona's history. To date, the State has made a total of \$1.05 billion in permanent budget reductions, eliminating critical state services and programs, and we reduced the state workforce by 10 percent. We have eliminated General Fund support for some services, which will result in increased fees and other assessments.

Despite these efforts and nearly full-time work since last January by myself and the Legislature – including three special sessions on the budget – the State is still facing a shortfall of more than \$1.5 billion in FY 2010 and a projected shortfall of \$3.2 billion in FY 2011, which equates to over 40 percent of our anticipated revenues. For the first time in the history of the State, we are borrowing money from an outside lender in order to meet our daily cash obligations.

While we have begun to see some brighter spots in our economy, the recovery is not coming fast enough, and when it does, it is expected to take at least 18 months before its effects are fully reflected in state government revenues. The economic forecasting firm of Economy.com is reporting that nationally, state government finances will not recover to the fiscal year 2008 level until fiscal year 2013.

The Fiscal 2011 Budget

As we consider the FY 2011 budget, elected officials, state government employees and our citizens are going to be facing some of the most monumental decisions that have ever been faced by our State. The budget that is developed over the next six months will result in a fundamental change in the services that are provided to Arizonans. The budget I will propose in January will reflect the reality that our cupboards are completely bare. After this current year we will have no more assets to sell, no more funds to sweep, and ARRA funding will expire.

My budget will contain the most significant expenditure reductions in state history. I also intend to continue to pursue necessary revenue increases if Arizona voters are willing to support them. These choices are difficult, but it is imperative that we tackle the budget situation honestly and with consideration for Arizona's future. We can no longer push these tough decisions off with one-time fixes that mask the underlying structural imbalances of our revenues and expenditures.

ARRA Maintenance of Effort Requirements

When the State accepted ARRA funding, we agreed to maintain spending for our K-12, community college and universities at the fiscal year 2006 levels. This commitment extends to the end of fiscal year 2011. It is a commitment that I will honor.

Another condition of accepting ARRA funding was our agreement to maintain our Medicaid eligibility criteria as of the date of ARRA's enactment. This commitment extends until December 2010. To provide context for this obligation, since the date of ARRA's enactment, our Medicaid enrollment has grown by over 300,000 lives.

As a result of these ARRA "maintenance of effort" requirements, of the \$10.3 billion "continuing service" budget for fiscal year 2011, \$6.8 billion of the expenditures enjoy federal protection, leaving us with \$3.4 billion in expenditures that are "available" for budget reductions; our fiscal year deficit is \$3.2 billion. Of the \$3.4 billion that is not federally protected, \$1 billion is for our Department of Corrections. These figures illustrate that I cannot erase our budget deficit through spending reductions alone. The simple truth is, even if I wanted to, I cannot reduce state expenditures to the level of state revenues. I cannot do this in part because of the Medicaid maintenance of effort requirements imposed on the State when we accepted ARRA funding.

Future Federal Action

Considering the tremendous challenges and difficult choices that Arizona faces with respect to its budget situation, I find the healthcare reform proposals deeply concerning. Arizona was one of fourteen states that enacted a significant expansion to our Medicaid system. While this expansion did result in an overall reduction to our uninsured rate, it has contributed to the skyrocketing costs of our Medicaid program and we are no longer able to afford the program that has been established. Washington is now talking about a mandated expansion of Medicaid as the foundation of a reform effort that is aimed at bringing down the costs of healthcare. Indeed, both current versions of the healthcare reform legislation expand the mandatory eligibility levels for Medicaid – to 133 percent of the Federal Poverty Level (FPL) in the Senate version and to 150 percent of FPL in the House version. Arizona's own experience has taught us that such expansions are often more costly than initially predicted, and these costs come at a time when states can least afford them.

Additionally, both versions contain a maintenance of effort requirement on state Medicaid programs that corresponds to the maintenance of effort requirements in ARRA. Arizona simply cannot afford to have this maintenance of effort requirement continued beyond its scheduled end date of December 31, 2009.

In light of Arizona's fiscal realities, I respectfully request that you consider the following two policies to assist our State on the road to recovery:

1. **If you are unable to prevent enactment of the overall proposal, please provide full federal funding for any mandated expansion of entitlement programs, including maintenance of effort requirements for previous state expansion populations.** To be clear, I believe it is the wrong time to pursue an entitlement expansion in this country. The mandated requirement that states expand Medicaid and keep it at a level that we cannot afford will ultimately lead to financial ruin. Rising Medicaid costs, including the costs of our expansion, have been one of the key contributing factors to the state budget crisis and have led Arizona to the brink of insolvency, as I am sure they have in other states. Arizona's General Fund spending on our Medicaid agency has increased by 230 percent over the past ten years, rising from 8 percent of total General Fund spending in fiscal year 1998-1999 to 16 percent ten years later. Under both the House and Senate proposals, states must maintain the current Medicaid program at the existing levels until the forced entitlement expansion occurs

at a future date. This is not a sustainable policy for the state of Arizona. Additionally, the Senate proposal results in a mandated expansion that is projected to increase the Arizona's costs by almost \$4.0 billion between now and FY 2020. Again, these are new costs on top of a program we already are unable to support. Furthermore, under the Senate proposal, Arizona does not receive an enhanced federal matching rate for the expansion we enacted to cover our entire state population up to 100 percent of the federal poverty level. Other states without such expansions will receive increased federal funding to bring their populations to levels Arizona has covered for almost a decade. Yet Arizona will be required to maintain this coverage. It is imperative that these populations be fully federally funded.

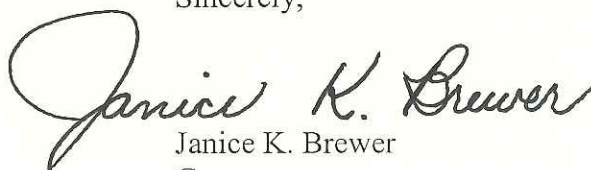
2. Provide states some flexibility with regards to maintenance of effort requirements.

Under both ARRA and the current mandated entitlement expansion discussions, Congress greatly limits state flexibility. Congress must realize that states need the ability to reduce the cost of entitlement programs that are consuming an ever-increasing percentage of the overall General Fund at the expense of other basic state services like education, public health and safety. The maintenance of effort requirements have basically locked state Medicaid programs into a pre-recession level without any acknowledgement that the revenue base in a state like Arizona has declined by 31 percent. Overall, federal mandates and maintenance of effort requirements have severely limited our ability to align our state expenditures with available revenues and made the difficult choices we have to make all the more challenging. Further, Arizona needs the ability to cap expansion populations, such as childless adults, that have been covered through the waiver process. As I stated above, the ARRA Medicaid maintenance of effort requirement should be allowed to expire at its scheduled end date of December 31, 2009, with no new additional maintenance of effort requirements.

I recognize that our delegation is made up of members with varying ideologies and party affiliations. That said, when I inherited this problem one year ago, I found myself having to quickly adjust my personal philosophies and apply them in circumstances I never believed I would face. I recognized the need for a balanced solution to our state's fiscal difficulties, which includes elements that are unpalatable to both sides of the political spectrum, but that is imperative to secure the future of our great state. Regardless of your overall perspective on healthcare reform or any other policy debate, I ask you to consider the ongoing fiscal challenges we continue to face, the fragile nature of our state and the best interests of our citizens when contemplating the critical issues facing Congress.

Please do not hesitate to contact me should you need additional information or clarification on any of these items.

Sincerely,

A handwritten signature in black ink that reads "Janice K. Brewer". The signature is fluid and cursive, with the first name "Janice" being larger and more prominent than the last name "Brewer".

Janice K. Brewer
Governor